CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 13, 2007

H.R. 1361
RECOVER Act

As passed by the House of Representatives on April 18, 2007

SUMMARY

H.R 1361 would amend the existing disaster loan program of the Small Business Administration (SBA), as well as authorize several new grant programs for individuals and businesses affected by Hurricanes Katrina, Rita, and Wilma. The act would:

- Establish a grant program for certain SBA borrowers that have been or will be required to prepay a portion of their disaster loan because they receive other payments;
- Establish a grant program for small businesses affected by the 2005 Gulf Coast hurricanes that were denied a SBA disaster loan;
- Lengthen the minimum deferment period for future SBA disaster loans;
- Authorize the refinancing of certain disaster loans with the option of deferring repayment for up to four years;
- Expand the Economic Injury Disaster Loan (EIDL) program to include private, nonprofit organizations;
- Increase the maximum loan that can be made for hazard mitigation purposes;
- Guarantee bridge loans to businesses affected by a disaster; and,
- Authorize certain private lenders to process, approve, disburse, and service SBA disaster loans.

CBO estimates that implementing H.R. 1361 would cost $2.5 billion over the 2008-2012 period, subject to the appropriation of the necessary funds. Enacting this legislation would not affect direct spending or revenues.

H.R. 1361 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the act is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By Fiscal Year, In Millions of Dollars				
	2008	2009	2010	2011	2012
CHANGES IN SPENDING SUBJECT TO APPROPRIATION					
Hurricane Assistance Replacement Grant Program					
Estimated Authorization Level	1,080	400	350	190	100
Estimated Outlays	864	536	360	222	118
Grants to Disaster-Affected Small Businesses					
Estimated Authorization Level	180	0	0	0	0
Estimated Outlays	72	72	36	0	0
Changes to Future SBA Disaster Loans					
Estimated Authorization Level	28	29	29	30	30
Estimated Outlays	14	25	29	29	30
Gulf Coast Disaster Loan Refinancing Program					
Estimated Authorization Level	44	6	0	0	0
Estimated Outlays	44	6	0	0	0
Economic Injury Disaster Loans to Private Nonprofit Organizations					
Estimated Authorization Level	3	3	3	3	3
Estimated Outlays	2	3	3	3	3
Other Provisions Affecting SBA					
Estimated Authorization Level	6	6	6	6	6
Estimated Outlays	4	5	5	6	6
Total Proposed Changes					
Estimated Authorization Level	1,341	444	388	229	139
Estimated Outlays	1,000	647	433	260	157

BASIS OF ESTIMATE

For this estimate, CBO assumes that this legislation will be enacted before the end of fiscal year 2007, that the necessary amounts will be appropriated for each year, and that spending will follow historical patterns for current and similar programs.

The budgetary impact of the act on SBA's credit programs is measured in terms of projected subsidy costs. Under the Federal Credit Reform Act (FCRA), such subsidy costs are estimated and recorded in the budget on a present-value basis. H.R. 1361 does not specify an explicit authorization level for either the subsidy or the administrative costs for the amendments it would make to SBA's disaster loan program or for the new loan guarantee program authorized by the act; CBO estimated those amounts using historical information about the demand for disaster loans and the past performance of SBA's disaster loan program.

Hurricane Assistance Replacement Grant Program

Section 211 would establish a grant program for individuals and businesses that received a SBA disaster loan as a result of Hurricanes Katrina, Rita, and Wilma, and have been or will be required under current law to prepay a portion of that loan upon receipt of other funds (for example, grants or insurance payments) that are considered to be a duplication of benefit. Based on historical experience and expected prepayments resulting from grants made by the Department of Housing and Urban Development, CBO estimates that borrowers will prepay about $2.4 billion to SBA (out of a total loan volume of $10.7 billion) under current law.

For this estimate, we assume that borrowers would be made aware of their eligibility in the grant program through their normal communications with SBA, that most would express interest, and that the agency would not implement an application process that is overly cumbersome. As such, we expect that 90 percent of eligible borrowers would apply for and receive a grant equal to the full amount prepaid (the maximum allowed in the act). CBO estimates that implementing this provision would cost $864 million in 2008 and $2.1 billion over the 2008-2012 period, assuming the appropriation of the necessary funds.

Grants to Disaster-Affected Small Businesses

Section 210 would establish a grant program for small businesses in certain areas of Texas, Louisiana, Mississippi, Alabama, and Florida affected by Hurricanes Katrina, Rita, and Wilma. Eligible small businesses include those that were denied traditional disaster loans and are determined to have long-term economic viability. The maximum amount of any such grant would be $100,000, and grants would be awarded on the condition that the business be reestablished in the disaster-affected region. About 18,000 businesses were rejected for traditional disaster loans in the applicable regions. Because they did not receive loans, CBO expects few businesses could be considered viable. Assuming that 10 percent of those applicants met the eligibility criteria specified in the act and were awarded the full grant value, CBO estimates that implementing this provision would cost $72 million in 2008 and $180 million over the 2008-2012 period, assuming appropriation of the necessary funds.

Changes to Future SBA Disaster Loans

Section 205 would require SBA to lengthen the time period during which borrowers may defer repayment of disaster loans to a minimum of 12 months after final loan disbursement. Furthermore, the act would require that repayment calculations be based solely upon the disbursed amount of the loan. Currently, SBA grants a minimum deferment period of five months following loan approval and calculates repayment based on the approved amount of the loan. Based on information from SBA, CBO expects that the deferment period for most disaster loans would increase to about 18 months under the act and that the revised repayment calculation would extend the total repayment period for a small number of loans. CBO estimates that implementing those provisions of H.R. 1361 would increase the future subsidy cost of disaster loans by about 3 percentage points. For this estimate, CBO assumed that the demand for SBA disaster loans over the next five years would average about $1 billion per year. This assumption is based on the historical average of approved disaster loans, including an additional amount reflecting the probability that another catastrophe similar to Hurricane Katrina could strike in a given year. On that basis, we estimate that implementing this provision would cost $127 million over the next five years. Such costs would be subject to appropriation action.

Section 207 would prohibit SBA from requiring a borrower to use his or her home as collateral for a business disaster loan of less than or equal to $100,000. Current law prohibits the collateral requirement for loans that are less than $10,000. For loans above this threshold, SBA prefers (but does not require) the use of a borrower's home as collateral. As such, CBO expects that this provision would not increase the number of loans approved by SBA, but that it could affect the recovery rates on any future loans that go into default. SBA does not consider the value of a home as collateral when estimating the subsidy rate for business disaster loans. Therefore, CBO expects that this provision would have a minor impact on the subsidy cost of such loans.

Gulf Coast Disaster Loan Refinancing Program

Section 219 would establish a program to refinance SBA disaster loans made to small businesses affected by Hurricanes Katrina, Rita, and Wilma. Loans refinanced under this new program would be identical to those under current law, except that the borrower would be given the option of deferring repayment for up to four years after the initial disbursement of the loan. Under current law, the deferment period of most SBA disaster loans ranges between five months and one year.

Extending the deferment period would increase the cost of these loans to the government because SBA would subsidize the interest rate over a longer period of time. Borrowers selecting this option would also face greater interest costs over time because SBA does not subsidize the full interest rate of its disaster loans. Therefore, borrowers would remain liable for any additional interest accrued during the deferment period. As such, CBO expects that 20 percent of eligible borrowers representing about $500 million in loans would extend their deferment period to the maximum of four years under this new program. Under the FCRA, the additional costs of refinancing these loans would be incurred at the time the new loan is made. As such, CBO estimates that implementing this provision would cost $50 million over the 2008-2012 period, subject to the appropriation of the necessary funds.

Economic Injury Disaster Loans to Private Nonprofit Organizations

Section 214 would expand SBA's Economic Injury Disaster Loans program to include private, nonprofit organizations. Under current law, the EIDL program makes direct loans to small businesses and small agricultural cooperatives that have suffered a substantial loss in business revenue as a result of a disaster. Based on the historical volume of physical disaster loans made to nonprofits and of EIDLs made to small businesses, CBO estimates that implementing this provision would cost $2 million in 2008 and $14 million over the 2008-2012 period for the subsidy and administrative cost of making additional loans.

Disaster Mitigation Loans

Section 201 would authorize SBA to make or guarantee loans for disaster mitigation up to a maximum of 20 percent of the assessed damage to a home or business. Currently, SBA offers direct loans for such purposes up to a maximum of 20 percent of the approved disaster loan. In some cases, SBA will make a disaster loan for less than the assessed damage due to factors such as reimbursements from other sources. Thus, H.R. 1361 would increase the maximum amount of a disaster mitigation loan by 20 percent of the difference between assessed damages and the approved loan amount. The act would apply this increase to loans made to small businesses and private, nonprofit organizations in the areas of Texas, Louisiana, Mississippi, Alabama, and Florida affected by Hurricanes Katrina, Rita, and Wilma, as well as to all future mitigation loans. The demand for such loans tends to be relatively small, and CBO estimates that implementing this provision would have a negligible effect on the federal budget over the next five years.

Immediate Disaster Assistance Program

Section 203 would establish an Immediate Disaster Assistance Program. Under the program, SBA would guarantee 85 percent of private loans, up to $25,000, made to businesses following a disaster. Once an application is received, SBA would be required to approve or disapprove such a loan guarantee within 36 hours. Upon approval of a traditional disaster loan for a business borrower, any amount guaranteed under the proposed Immediate Disaster Assistance Program would be immediately repaid. Such a program to “bridge” the time period between the need for a loan and the availability of a traditional disaster loan would be similar to one already operated by SBA for certain nondisaster loans. Based on information from the agency, CBO expects that demand for SBA loans would not be significantly altered under such new authority, although additional risk would be incurred for borrowers that receive loan guarantees and are later denied a traditional disaster loan. Because that is not likely to occur often, CBO estimates that this program would have a negligible cost over the next five years.

Enhanced Lending Authority for Private Lenders

Section 208 would direct SBA to establish a program whereby certain private lenders would be permitted to process, approve, close, and service disaster loans. This program could be implemented at any time at the discretion of the SBA, but would be required when a disaster of national significance occurs or when the average approval period for disaster loans exceeds 30 days. For this work, SBA would pay participating private lenders a servicing fee of up to 2 percent of the total loan amount approved by the private lenders.

CBO expects that such a program would be used infrequently following rare catastrophic events. The existence of the Disaster Reserve Corps that would be authorized by this act would lessen the need to use private lenders. Assuming minimal differences in the default rates and administrative expenses of loans made by private lenders and those made by SBA, CBO estimates that implementing this provision would have a negligible effect on the federal budget. It is possible, however, that having private lenders approve, disburse, close, and service direct federal loans could change—perhaps significantly—the subsidy rate for future disaster loans. There is no precedent for this type of private-sector involvement in issuing federal loans, and CBO has no basis for judging whether and how subsidy rates would change as a result of this provision.

Other Provisions

Based on information from SBA, CBO estimates that implementing other provisions of H.R. 1361 would require appropriations totaling $30 million over the next five years. That amount includes:

- $15 million to maintain a Disaster Reserve Corps of 1,000 individuals, including training and an annual simulation exercise;

- $10 million to ensure that a backup loan-processing facility could become operational within two days of a primary facility becoming unavailable; and

- $5 million to create separate Directors of Disaster Assistance and Planning, including additional support staff.

Those estimates are based on information from SBA regarding costs of existing or similar programs. Based on historical spending patterns, CBO estimates that fully funding those activities would cost $4 million in 2008 and $26 million over the next five years, assuming appropriation of the necessary amounts.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 1361 contains no intergovernmental or private-sector mandates, as defined in UMRA, and would impose no costs on state, local, or tribal governments.

PREVIOUS CBO ESTIMATE

On March 29, 2007, CBO provided a cost estimate for H.R. 1361, the RECOVER Act, as ordered reported by the House Committee on Small Business on March 15, 2007. The House-passed version of the legislation differs from the previous version in a number of ways. That previous version included a provision granting SBA the authority to partially or fully waive the requirement that borrowers prepay disaster loans upon receipt of other funds, which CBO estimated would increase direct spending by $215 million over the 2007-2009 period. That provision has been replaced in the House-passed version with a grant program that is subject to appropriation.

In addition, the House-passed version would authorize the appropriation of such funds as are necessary for SBA to establish a program to refinance loans made to borrowers affected by the 2005 Gulf Coast hurricanes. In total, CBO's estimate of direct spending for H.R. 1361, as passed by the House, is $215 million less than the amount of direct spending estimated for the previous version over the 2007-2012 period; in contrast, the estimate of spending subject to appropriation is $2.15 billion higher.

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